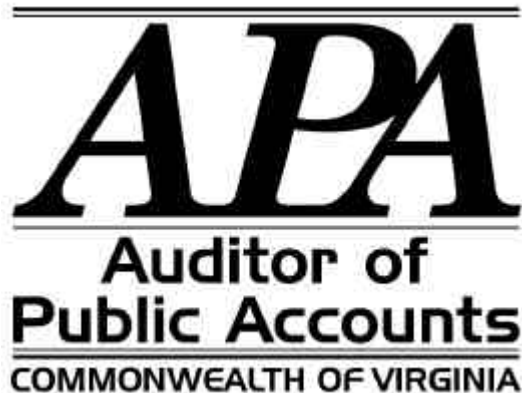


**DEPARTMENT OF MEDICAL ASSISTANCE SERVICES
RICHMOND, VIRGINIA**

**REPORT ON AUDIT
FOR THE YEAR ENDED
JUNE 30, 2003**



AUDIT SUMMARY

Our audit of the Department of Medical Assistance Services for the year ended June 30, 2003, found:

- amounts reported in the Commonwealth Accounting and Reporting System and the Department's accounting records were fairly stated;
- a weakness in internal controls that we consider a reportable condition;
- no instances of noncompliance that are required to be reported under Government Auditing Standards; and
- adequate corrective action for all prior year audit findings.

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AGENCY OVERVIEW

The Department of Medical Assistance Services (the Department) administers the Commonwealth's indigent health care programs. These programs include Medicaid, Family Access to Medical Insurance Security (FAMIS), the Indigent Health Care Trust Fund, Income Assistance for Regular Assisted Living, Involuntary Mental Commitments, and other medical assistance services such as HIV assistance and state and local hospitalization.

The Medicaid program provides medical coverage to individuals who are aged, blind, disabled, pregnant, and eligible children, living in families with gross income below 100 percent of the federal poverty level. In fiscal year 2003, the program expanded to provide coverage to children from age 6 through 18 in families with gross income between 100 and 133 percent of the federal poverty level. FAMIS covers children in families with gross income between 133 and 200 percent of the federal poverty level.

FINANCIAL INFORMATION

The schedules below summarize the Department's budgeted revenues and expenses compared with actual results for fiscal year 2003.

Analysis of Budget and Actual Revenue by Funding Source Fiscal Year Ended June 30, 2003

<u>Funding Source</u>	<u>Original Budget</u>	<u>Adjusted Budget</u>	<u>Actual</u>
General Fund appropriations	\$1,694,466,744	\$1,818,322,292	\$1,818,322,292
Federal grants	1,807,787,960	1,957,642,774	1,993,906,129
Special revenue funds	7,850,000	75,725,786	91,378,449
Dedicated special revenue	<u>12,417,373</u>	<u>18,371,978</u>	<u>43,852</u>
Total resources	<u>\$3,522,522,077</u>	<u>\$3,870,062,830</u>	<u>\$3,903,650,722</u>

The Department adjusted its original general and federal fund budgets primarily for inflation in Medicaid costs and for providing services to an increasing number of low-income children, elderly, and disabled persons. Actual revenue exceeded that amount due to a temporary increase in the federal Medicaid match rate pursuant to the Jobs and Growth Tax Relief Reconciliation Act of 2003, which increased from 50.53 percent to 54.40 percent and netted the Commonwealth approximately \$34 million.

The Department adjusted its original special revenue budget in order to receive revenue from several localities within the Commonwealth having locally-owned-and-operated nursing homes and hospitals. In May and June of 2003, in accordance with special provisions of the federal Medicaid legislation, the Department received as special revenue a total of \$86.4 million and recorded a corresponding expense of \$67.9 million. The Department transferred the remaining \$18.5 million to the Commonwealth's General Fund.

The Department's dedicated special revenue funds support the FAMIS and Medicaid Expansion programs. The source of these funds is primarily a transfer from the Commonwealth's General Fund. During fiscal year 2003, the Department received a total of \$14 million in cash transfers from the Commonwealth's General Fund.

**Analysis of Budgeted and Actual Expenses by Program
Fiscal Year Ended June 30, 2003**

<u>Program</u>	<u>Original Budget</u>	<u>Adjusted Budget</u>	<u>Actual</u>
Medicaid	\$3,315,000,154	\$3,648,419,739	\$3,643,148,864
Administration and support (Medicaid)	107,877,219	125,808,892	118,790,101
FAMIS (includes administrative costs)	66,355,617	60,228,493	60,003,547
Non-Medicaid services	14,306,044	14,408,865	11,981,834
Indigent health care trust	10,000,000	10,215,275	7,756,143
Appellate processes	7,370,091	9,368,614	9,134,601
Continuing income assistance	<u>1,612,952</u>	<u>1,612,952</u>	<u>1,422,625</u>
Total	<u>\$3,522,522,077</u>	<u>\$3,870,062,830</u>	<u>\$3,852,237,715</u>

**Analysis of Budgeted and Actual Expenses by Program Funding Source
Fiscal Year Ended June 30, 2003**

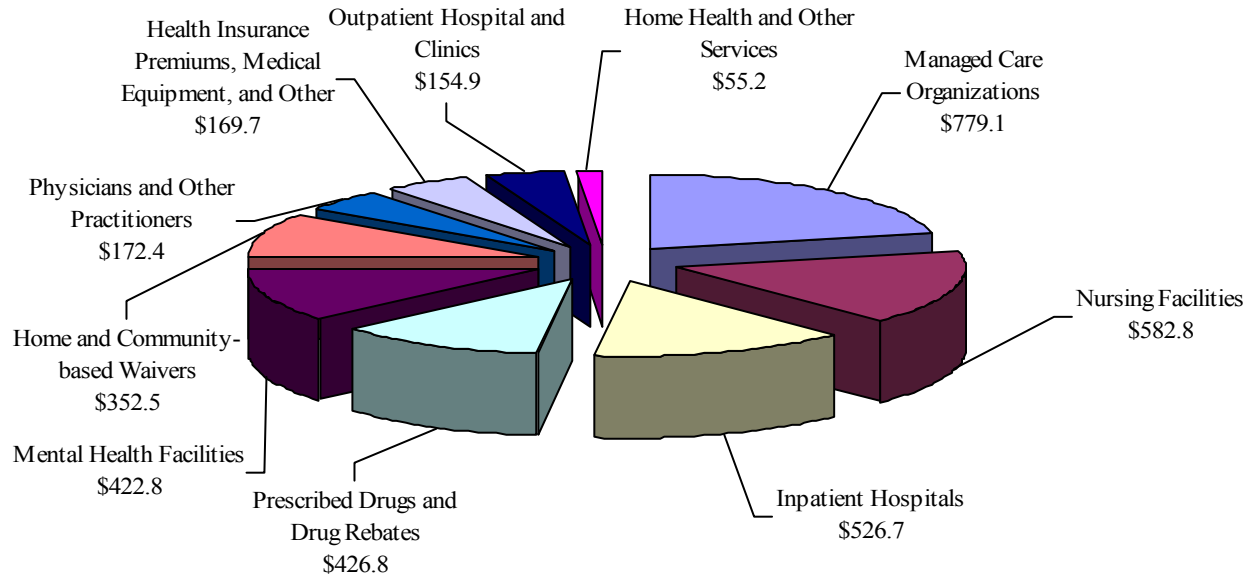
<u>Program</u>	<u>General</u>	<u>Special</u>	<u>Dedicated</u>	<u>Federal</u>
Medicaid	\$1,736,804,158	\$66,527,557	\$ 4,117,245	\$1,835,699,904
Administration and support (Medicaid)	45,832,758	1,346,496	-	71,610,847
FAMIS (includes administrative costs)	6,486,603	-	14,059,905	39,457,039
Non-Medicaid services	10,081,307	1,889,527	11,000	-
Indigent health care trust	5,215,216	2,540,927	-	-
Appellate processes	9,134,601	-	-	-
Continuing income assistance	<u>1,422,625</u>	<u>-</u>	<u>-</u>	<u>-</u>
Total	<u>\$1,814,977,268</u>	<u>\$72,304,507</u>	<u>\$18,188,150</u>	<u>\$1,946,767,790</u>

Total Department expenses for all programs amounted to \$3.85 billion in fiscal year 2003. Approximately, 96 percent of this amount represents medical expenditures attributable to the Medicaid and FAMIS programs. Another three percent of the total amount represents administrative expenses for these two programs.

Medicaid

The Department spent \$3.6 billion on Medicaid Assistance Services. The following chart shows total medical expenses for the Medicaid program by provider type.

Medicaid Expenses by Provider Type
Fiscal Year Ended June 30, 2003
(in millions)



In addition to Medical Assistance Services, the Department spent \$119 million on administrative costs. The schedule below summarizes the administrative expenses related to the Medicaid program.

Personal services	\$ 18,035,995
Contractual services	97,368,580
Supplies and materials	460,944
Transfer payments	315,884
Continuous charges	2,105,426
Property, plant, and equipment	<u>503,272</u>
Total expenses	<u>\$118,790,101</u>

Of the \$97 million spent on contractual services, the Department paid its largest vendor, First Health Services Corporation (First Health), \$36 million. As the Department's fiscal agent, First Health runs the day-to-day operations of the Medicaid program by processing claims and enrolling providers. First Health is also responsible for developing and maintaining the Department's new Medicaid Management Information System (MMIS).

FAMIS

FAMIS' medical expenses amounted to \$54.6 million; of this amount, \$41.5 million represents managed care organization payments, an increase of \$16.8 million from fiscal year 2002. Administrative expenses totaled \$5.4 million with 41 percent paid to a contractor for FAMIS enrollment and eligibility determination services.

AGENCY HIGHLIGHTS

Budget Reductions

Budget cuts for the 2003-2004 biennium totaled 19 percent and resulted in an additional administrative cut of \$12.2 million in fiscal year 2003. To absorb these cuts, the Department now enforces stricter application of nationally recognized standards to determine the medical necessity of inpatient hospital admissions. The Department awarded its Medicaid managed care enrollment broker contract to Maximus, who replaced Concera (formerly Benova), for a lower contract amount and also did not fill vacant positions.

Other cost saving strategies included a reduction in pharmaceutical costs, expedited access to generic drugs, and enhanced drug utilization reviews. The Department reduced payments to nursing facilities and managed care organizations through rate reductions. The Department stated that budget reductions did not affect medical services to Medicaid patients. The Department budgeted similar cuts and saving strategies for fiscal year 2004.

Medicaid Management Information System

In June 2003, the Department and First Health successfully implemented the new Medicaid Management Information System (MMIS). As with any new system, start-up problems occurred after implementation; however, none proved to be significant. The Department continues to monitor the system through quality reviews, user input, and provider input. In July 2003, the MMIS processed over \$3 million in claims and as of December 2003, reached \$1.9 billion in paid claims. The Centers for Medicare and Medicaid Services (CMS) certifies a new system only after it has been implemented and in operation for six months; therefore, the Department plans to apply for certification at the beginning of calendar year 2004.

In accordance with Federal regulations, the MMIS must comply with the Health Insurance Portability and Accountability Act (HIPAA) by October 2003. HIPAA provides standards for the billing and payment of health claims and medical information and federal protection for health information. This set of federal regulations creates standards for the preparation and communication of health information and controls the privacy of patient information. HIPAA encompasses system security, privacy, and electronic transaction requirements. In February 2003, an outside contractor performed a review of the Department's HIPAA privacy policies and procedures and determined them to be compliant. The new MMIS began accepting and producing electronic transactions in the required HIPAA electronic standard format at implementation, four months in advance of the October 2003 compliance date. Currently, the Commonwealth of Virginia is one of only three state Medicaid agencies that are HIPAA compliant. A security review by an outside contractor is underway as of December 2003.

Preferred Drug List Program

The 2003 Appropriations Act directs the Department to amend the State Plan for Medical Assistance Services to modify the delivery system of pharmaceutical products to include a Preferred Drug List program no later than January 1, 2004. The Act further directs the Department to seek input from physicians, pharmacies, and others; to form a Pharmacy & Therapeutics (P&T) Committee; and to ensure drugs on the list are safe and clinically effective before considering cost effectiveness. The P&T Committee will recommend to the Department the classes of drugs that are subject to the preferred drug list and prior authorization requirements, the specific drugs within each class to be included on the list, and appropriate exclusions from the list. The Department contracted with First Health to establish and administer a Preferred Drug List program for Medicaid fee-for-service clients and a prior authorization program for Medicaid and FAMIS fee-for-services. The overall goal is to improve the quality, coordination, and management of pharmacy benefits, while controlling pharmaceutical expenditures. The Department anticipates at least \$9 million in General Fund savings in fiscal year 2004 and at least \$18 million in General Fund savings in subsequent fiscal years.

INTERNAL CONTROL FINDING

CMS requires each state to operate an approved Medicaid Eligibility Quality Control (MEQC) system. The MEQC system redetermines recipient eligibility for Medicaid and projects the dollar impact of payments to ineligible beneficiaries. Historically, the Commonwealth has reported a three percent error rate, which met federal standards. As a result of this low error rate, the Commonwealth received authorization to participate in a MEQC Pilot Project. This pilot differs from the traditional system in that it provides states an opportunity to customize their eligibility quality control process to address specific problems affecting their state. By establishing a pilot, the Department can experiment with alternative testing methods without risk of federal sanctions. The Department has initiated eight pilots focusing on eligibility determinations for groups such as long-term care and medically-indigent recipients.

Develop Formal Medicaid Eligibility Quality Control (MEQC) Review Policies and Procedures

The Department does not have adequate policies and procedures to monitor and control the submission, resolution, and completion of the MEQC pilots. The Department did not send the error rate analysis and corrective action plans for the two pilots that ended in March 2002 and April 2002 to the Center for Medicaid and State Operations (CMS) until November 2003, over 19 months after the sample period ended. For other pilots reviewed, we could not determine the submission dates to CMS of error analysis and corrective action plans due to inadequate documentation. Furthermore, the error rate analysis and corrective action plans for all pilots were developed anywhere from one year and seven months to over two years after the sample period ended.

The Department has not developed formal policies and procedures to ensure:

- Memorandums of Understanding include realistic target dates of information received from the Department of Social Services (DSS);
- they submit error summary results and corrective action plans to CMS on a timely basis; and
- they maintain adequate documentation supporting all pilots.

The Department spent almost \$2 billion in federal dollars for the Medicaid program. DSS plays a very critical role in determining eligibility for the Medicaid program. The Department should ensure that they receive the necessary information timely from DSS in order for the Department to review and improve controls over the Medicaid eligibility function. If DSS cannot provide the information in a timely manner, the Department should consider hiring an outside contractor to perform the function.

The Department appears to be performing MEQC pilot requirements; however, failure to develop pilot policies and procedures that address timely submission and analysis of results; and failure to maintain adequate documentation may result in the inability of the Commonwealth to participate in future MEQC pilots. Furthermore, material weaknesses in internal controls around MEQC pilots could result in the auditor questioning some, most, or all costs relating to eligibility determination for the Medicaid program.

Agency Response: *The Department concurs, see actions taken on page 8.*



Commonwealth of Virginia

Walter J. Kucharski, Auditor

Auditor of Public Accounts
P.O. Box 1295
Richmond, Virginia 23218

January 6, 2004

The Honorable Mark R. Warner
Governor of Virginia
State Capitol
Richmond, Virginia

The Honorable Lacey E. Putney
Vice Chairman, Joint Legislative Audit
and Review Commission
General Assembly Building
Richmond, Virginia

INDEPENDENT AUDITOR'S REPORT

We have audited the financial records and operations of the **Department of Medical Assistance Services** for the year ended June 30, 2003. We conducted our audit in accordance with Government Auditing Standards, issued by the Comptroller General of the United States.

Our audit's primary objectives were to evaluate the accuracy of recording financial transactions on the Commonwealth Accounting and Reporting System and in the Department's accounting records, review the adequacy of the Department's internal control, and test compliance with applicable laws and regulations. We also reviewed the Department's corrective actions of audit findings from prior year reports.

Our audit procedures included inquiries of appropriate personnel, inspection of documents and records, and observation of the Department's operations. We also tested transactions and performed such other auditing procedures, as we considered necessary to achieve our objectives. We reviewed the overall internal accounting controls, including controls for administering compliance with applicable laws and regulations. Our review encompassed controls over the following significant cycles, classes of transactions, and account balances:

Expenditures	Accounts Receivable
Revenues	Accounts Payable
General System Controls	

We obtained an understanding of the relevant internal control components sufficient to plan the audit. We considered materiality and control risk in determining the nature and extent of our audit procedures. We performed audit tests to determine whether the Department's controls were adequate, had been placed in operation, and were being followed. Our audit also included tests of compliance with provisions of applicable laws and regulations.

The Department's management has responsibility for establishing and maintaining internal control and complying with applicable laws and regulations. Internal control is a process designed to provide

reasonable, but not absolute, assurance regarding the reliability of financial reporting, effectiveness and efficiency of operations, and compliance with applicable laws and regulations.

Our audit was more limited than would be necessary to provide assurance on internal control or to provide an opinion on overall compliance with laws and regulations. Because of inherent limitations in internal control, errors, irregularities, or noncompliance may nevertheless occur and not be detected. Also, projecting the evaluation of internal control to future periods is subject to the risk that the controls may become inadequate because of changes in conditions or that the effectiveness of the design and operation of controls may deteriorate.

Audit Conclusions

We found that the Department properly stated, in all material respects, the amounts recorded and reported in the Commonwealth Accounting and Reporting System and in the Department's accounting records. The Department records its financial transactions on the cash basis of accounting, which is a comprehensive basis of accounting other than accounting principles generally accepted in the United States of America. The financial information presented in this report came directly from the Commonwealth Accounting and Reporting System and the Department's accounting records.

We noted a certain matter involving internal control and its operation that we consider to be a reportable condition. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of internal control that, in our judgment, could adversely affect the Department's ability to record, process, summarize, and report financial data consistent with the assertions of management in the financial records. The reportable condition is described in the section titled "Internal Control Finding." We believe that the reportable condition is not a material weakness.

The results of our tests of compliance with applicable laws and regulations disclosed no instances of noncompliance that are required to be reported under Government Auditing Standards.

The Department has taken adequate corrective action with respect to audit findings reported in the prior year.

This report is intended for the information and use of the Governor and General Assembly, management, and the citizens of the Commonwealth of Virginia and is a public record.

We discussed this report with management on February 4, 2004.

AUDITOR OF PUBLIC ACCOUNTS

JHT/kva
kva:43



COMMONWEALTH of VIRGINIA

Department of Medical Assistance Services

PATRICK W. FINNERTY
DIRECTOR

February 6, 2004

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Walter Kucharski
Auditor of Public Accounts
James Monroe Building, 8th Floor
101 North 14th Street
Richmond, VA 23219

Dear Mr. Kucharski:

This letter is to convey the Department's response to your audit finding for the Department of Medical Assistance Services. Our response to the audit point is below.

Finding: Develop Formal Medicaid Eligibility Quality Control (MEQC) Review Policies and Procedures

The Virginia Department of Medical Assistance Services (DMAS) agrees that there could be improvement in the documentation of future Medicaid Eligibility Quality Control pilots. DMAS and the Virginia Department of Social Services (DSS) are developing pilot study implementation plans including deliverables and timelines that will improve the documentation and management of the pilot studies by DMAS and DSS. In addition, the Memorandum of Understanding (MOU) is being revised to ensure timely submission of corrective action plans to the Centers for Medicare and Medicaid (CMS).

We are committed to the timely resolution of the issues identified in your audit finding by May 1, 2004.

Sincerely,

A handwritten signature in black ink, appearing to read "P. Finnerty", written over a horizontal line.

Patrick W. Finnerty
Director

PWF/dg

DEPARTMENT OF MEDICAL ASSISTANCE SERVICES
Richmond, Virginia

Patrick Finnerty, Agency Director

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